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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment to The Bell Atlantic	)	Transmittal Nos. 741, 786
Telephone Companies	)	Amended
Tariff FCC No. 10	)	
	)	CC Docket No. 95-145
Video Dialtone Service	)	

BELL ATLANTIC DIRECT CASE

Introduction and Summary

Direct Case

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INTRODUCTION AND SUMMARY OF BELL ATLANTIC DIRECT CASE

Bell Atlantic[1] hereby submits its Direct Case justifying those rates, terms and conditions in its video dialtone tariff for Dover Township, New Jersey that were designated for investigation in this proceeding.[2]

The question before the Commission in conducting its investigation of Bell Atlantic's video dialtone tariff is whether the rates, terms and conditions of the tariff are unlawful -- not whether the Commission or other parties might find other rates, terms and conditions to be preferable. As Bell Atlantic's direct case clearly demonstrates, its tariff terms are both lawful and commercially reasonable. The Commission should close its investigation without modification to the tariff.

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[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

[2] Order Designating Issues for Investigation, Trans. Nos. 741, 786, CC Docket No. 95-145 (rel. Sept. 8, 1995) ("Dover Investigation Order").

I. **The Issue Before the Commission is Narrowly Limited**

In the direct case, Bell Atlantic has provided all of the information and data requested by the Commission to assist it in investigating the lawfulness of Bell Atlantic's tariff rates, terms and conditions for video dialtone service in Dover Township, New Jersey. Several of the Commission's information requests, however, are directed not at determining whether Bell Atlantic's tariff terms are lawful, but at evaluating whether other services or tariff terms that Bell Atlantic has not proposed would be preferable to the Commission, video dialtone customers or video dialtone competitors. To this extent, such information is not relevant to this tariff investigation, and is being provided by Bell Atlantic without waiving our right to challenge the legality of the requirement.

For example, the Commission has asked Bell Atlantic to explain why its method of allocating non-incremental shared primary plant costs "results in a more reasonable allocation of [such] costs than do...other allocation methods."[3] That is not the appropriate test, however. As the Commission has acknowledged, any method of allocating shared costs is, by definition, arbitrary.[4] In fact, the Commission has not prescribed any particular methodology that must be applied in all cases. Therefore, the only question

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3 Dover Investigation Order, ¶ 27.

4 *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244, ¶ 217; *see also* Affidavit of Dr. William L. Taylor (Oct. 25, 1995), ¶ 4 ("Taylor Direct Case Affidavit"), attached as Exhibit A.

before the Commission is whether Bell Atlantic's chosen methodology is reasonable -- not whether some other methodology would be preferable.

The Commission has also asked whether Bell Atlantic should be required to offer different services for use by part-time or one-time users.[5] Bell Atlantic believes that any potential market demand can be met by the services offered here, by pointcast services to be offered in the future or by resellers, who can also provide the ancillary services necessary to make such access commercially viable.[6] Similarly, the Commission has asked Bell Atlantic to explain why it has not offered other services, such as term discounts for terms of less than five years.[7] As Bell Atlantic explains in its direct case,[8] Bell Atlantic is offering only a 5-year term discount at this time based on conversations with potential programmer-customers and Bell Atlantic's evaluation of market demand for term discounts. If *bona fide* market demand for intermediate term discounts materializes, Bell Atlantic could choose to pursue adding such options in subsequent tariff filings.

The Commission lacks authority to require a carrier to

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[5] Dover Investigation Order, ¶ 57.

[6] *See* Response to Information Request O, Direct Case at 108.

[7] Dover Investigation Order, ¶ 46 (requiring Bell Atlantic to explain "why it has offered only a five year term discount and not terms of shorter duration that might be more attractive to a wider group of programmers.")

[8] *See* Response to Information Request K(2), Direct Case at 89.

offer other services or terms that the Commission believes may be desirable but that the carrier has not chosen to offer. That is because the Commission has statutory authority to determine only whether a carrier's tariff terms are lawful;[9] similarly, the Commission may prescribe "just and reasonable" tariff rates only if the Commission has first made the threshold determination that a tariff as filed is unlawful.[10] It is the responsibility and prerogative of the carrier, in the exercise of its business judgment and with knowledge of local market conditions and customer demand in its service area, to determine what services it will offer and on what terms. That is particularly important here, where Bell Atlantic is risking its capital to provide a new service in competition with incumbent cable operators that dominate the market. So long as those service terms do not violate the Communications Act, the Commission may not require modification of those terms.[11]

Because Bell Atlantic's tariff rates, terms and conditions fully comply with the Act and the Commission's rules, for the reasons explained below in Bell Atlantic's Direct Case, this investigation should be terminated without requiring any tariff modifications.

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[9] 47 U.S.C. § 204(a)(1).

[10] 47 U.S.C. § 205(a).

[11] *Id.*

II. Cost Studies, Not Accounting Records, Are The Appropriate Source of Data Against Which to Evaluate Tariff Rates

The Commission has asked Bell Atlantic to provide certain accounting data in connection with its investigation of video dialtone service rates. The Commission's Order implies that Bell Atlantic should be maintaining subsidiary accounting records now that show the booked portion of shared investments for the Dover system that have been allocated to the video dialtone service.[12] Pursuant to Part 32.2000(e)(4) of the Commission's rules, however, such subsidiary records may not be created until the network is ready for service. At that time, the investment associated with the Dover system that is currently charged to the Part 32.2003 Account -- "Telecommunications Plant under Construction" -- will be moved to the Part 32.2001 Account -- "Telecommunications Plant in Service"[13] -- and will be categorized to appropriate subsidiary accounts as required.

Moreover, accounting data is irrelevant to the Commission's inquiry here because the projection of costs for a new service tariff and the categorization of costs to particular service accounts for accounting purposes are not fairly comparable. New service tariffs rely on cost studies to estimate the projected costs to provide a service in a mature market, based on "average" characteristics of the facilities, equipment and labor required to do so. These projected costs include the direct costs of the

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[12] Dover Investigation Order, ¶ 18.

[13] *See* Response to Information Request B(4), Direct Case at 33.

facilities used to provide video dialtone service, plus a reasonable allocation of common equipment.

In contrast, accounting costs are actual costs incurred on an historic basis. Actual costs reflect the system as actually built; as a result actual costs will vary both in amount and over time as a result of changing conditions that could not have been foreseen at the time of the tariff projections. More importantly, the actual expenditures reported to accounting records for the Dover build represent not just the portion of facilities used to provide video dialtone service, but the full cost of all facilities to be constructed to provide present and future narrowband and broadband services in Dover Township, including video dialtone. Such figures include expenditures for placement of excess capacity to support future growth.[14] Because these costs are calculated in different ways for different purposes, the projected costs in the cost study Bell Atlantic used to set video dialtone rates can not be fairly compared to actual expenditures from accounting records.

III. The Commission Should Withhold From Public Inspection Certain Proprietary Vendor Pricing Information

In its May 5, 1995 filing of comprehensive cost study material in this proceeding, Bell Atlantic redacted certain pricing information considered to be proprietary by Bell Atlantic or its vendors or information that, if provided, would lead to the direct

[14] For a more detailed discussion of the major differences between projected construction costs developed from the tariff cost study and actual capital expenditures for particular network components, see Bell Atlantic's response to Information Request Pre(2) in the Direct Case materials that follow.

calculation of this proprietary information. The Commission has now directed Bell Atlantic to provide to the Commission all of the redacted data included in that submission.[15] Bell Atlantic has complied with the Commission's direction without waiving its right to challenge the legality of the requirement.[16]

Disclosure of vendor pricing data for each specific component of the equipment that will be used to provide video dialtone service is unnecessary for any regulatory purpose. Bell Atlantic has already provided cost support material for this tariff that goes beyond that repeatedly accepted by the Commission in other tariff filings.[17] For example, Bell Atlantic separately identified, by account, the amount of incremental investment allocated to video, voice and joint use, as well as total video dialtone investment per potential subscriber.[18] Bell Atlantic has also previously supplied aggregate cost information for the facility and equipment investments included in each rate element.[19]

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[15] Dover Investigation Order, ¶ 10.

[16] An unredacted copy of the May 5th filing, under seal, will be filed with the Commission only. A copy of the May 5th filing that redacts certain vendor pricing information still deemed proprietary by Bell Atlantic and its vendors is included as Attachment Pre(1) to this filing.

[17] *See, e.g.*, Bell Atlantic Transmittal Nos. 509 (tariff filed May 8, 1992, order rel. June 19, 1992); No. 655 (tariff filed May 21, 1994, effective date June 16, 1994); No. 703 (tariff filed Oct. 7, 1994, effective date Nov. 21, 1994); and No. 708 (tariff filed Oct. 28, 1994, effective date Dec. 12, 1994).

[18] D&J, Workpapers 5-3, 5-4, 5-5, 5-8, 5-9 and 5-10.

[19] The Bell Atlantic Telephone Cos., Transmittal No. 741-A, Cost Study, Tabs 2-5 (filed May 5, 1995).

In its Direct Case, which follows, Bell Atlantic has further disaggregated its cost study data by providing additional details, including total construction and operations costs by network component and by category of investment (video only, voice only or joint use); additional quantities and unit investments; and investments and cost components resulting from various allocation methodologies. Given the detailed information already on the record and that evaluation of tariff prices is based on total service costs applicable to each rate element, there is no need to reveal competitively sensitive vendor-negotiated prices of *individual* equipment components within each rate element in order for the Commission or third parties to determine whether Bell Atlantic's tariffed rates lawfully cover its costs to provide video dialtone service.

Because the Commission has nevertheless required that such information be provided to the Commission, Bell Atlantic respectfully requests that the Commission waive the requirements of 47 C.F.R. §§ 0.453(j) and 0.455(b)(11) and withhold from public inspection, pursuant to 47 C.F.R. §§ 0.457(d), 0.459 and 0.461, the vendor pricing information that has been redacted in Attachment Pre(1) to this filing. Bell Atlantic's request is limited to the entries on that Attachment, and does not extend to the other financial data contained in any other documents or workpapers comprising this direct case filing. Bell Atlantic requests that the redacted information set forth in that Attachment not be made routinely available for public inspection because of the potential competitive harm such disclosure may impose on Bell Atlantic and its vendors.

This pricing information contains specific breakdowns of equipment sub-components, disclosure of which would be prejudicial to the ability of Bell Atlantic and its vendors to compete effectively in the video services market. Broadband Technologies, Inc. ("BBT"), the primary network equipment vendor for the Dover build, has previously written to the Commission to explain the "serious and irreparable competitive harm"[20] BBT would suffer if its equipment prices were to be publicly disclosed:

> If the redacted information were made public, Broadband Technologies' competitors could modify their own pricing structures to BroadBand Technologies' competitive disadvantage. Competitors that have entered the integrated switched digital broadband networking market, which BroadBand Technologies pioneered, would use such information to determine the costs of specific interface types, service types, and network elements of BroadBand Technologies' broadband access and transport system. Competitors also could derive detailed information about the configuration of the system. Further, the redacted information would allow BroadBand Technologies' competitors and suppliers to predict the timing and volume of equipment orders from Bell Atlantic. Disclosure of the information also would place BroadBand Technologies at a severe disadvantage in negotiating pricing and delivery schedules with other potential customers.[21]

Bell Atlantic would suffer similar competitive harm if its cost data -- down to the price for each network equipment component -- must be shared publicly. The majority of commenters

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[20] Letter from Janice Obuchowski, counsel to BroadBand Technologies, Inc., to Mr. William Caton, Acting Secretary, Federal Communications Commission (May 19, 1995) at 1.

[21] *Id.* at 2.

in proceedings on the tariff for this service have been Bell Atlantic's direct competitors in the video market: the incumbent cable operators. It would be extremely damaging to require any company to share such highly sensitive, competitively valuable intelligence with its competitors. It is particularly harmful where, as here, the party forced to disclose that information is a new market entrant with zero market share and the information is going to the incumbent providers who already dominate the market.

In addition, vendors are likely to be less willing in the future to negotiate concrete prices and terms for sales of broadband equipment to Bell Atlantic until all regulatory proceedings are completed and the risks of mandatory disclosure have passed. Given the lead time required to construct these advanced digital networks, delay in reaching a binding agreement with vendors on prices until a tariff investigation is concluded would significantly delay Bell Atlantic's market entry.

Worse yet, vendors may be reluctant to negotiate particularly favorable prices for Bell Atlantic if such prices will be disclosed to the entire industry. Bell Atlantic's equipment costs would therefore increase, resulting in an increase in the prices it must charge programmer-customers for video dialtone service. Such higher transport costs would put additional pressure on existing programmer-customers' margins, reduce demand by existing and potential new programmer-customers for channel capacity, and undermine the viability of this new service.[22]

Both Congress[23] and the Commission[24] have recognized the legitimate commercial interest in protecting the privacy of proprietary business data. For that reason, the Commission has previously restricted disclosure of proprietary vendor pricing information in other instances by making release subject to appropriate nondisclosure safeguards.[25] Such safeguards accomplish "the dual purpose of protecting competitively valuable information while still permitting limited disclosure for a specific public purpose."[26]

Bell Atlantic therefore respectfully requests that the Commission restrict disclosure of such redacted data -- and to limit the use of such data solely to this proceeding -- only to those parties that have agreed to comply with the terms of the Nondisclosure Agreement attached as Exhibit C, and whose authorized

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22 ***See*** Declaration of Mr. Robert J. Rider, Director, Bell Atlantic Network Services, Inc. (Oct. 25, 1995) ("Rider Declaration"), attached as Exhibit B.

23 ***See*** The Freedom of Information Act, 5 U.S.C. § 522.

24 ***Petition of Public Utilities Commission, State of Hawaii, For Authority to Extend its Rate Regulation of Commercial Mobile Radio Services in the State of Hawaii***, 10 FCC Rcd 2359, at ¶ 27 (Com. Car. Bur. 1995) ("***Hawaii PUC Petition***").

25 ***Id.***, at ¶¶ 44-45; ***Commission Requirements for Cost Support Material To Be Filed With Open Network Architecture Tariffs***, 7 FCC Rcd 1526, at ¶¶ 27-29 (Com. Car. Bur. 1992).

26 ***Hawaii PUC Petition***, 10 FCC Rcd 2359, at ¶ 27.

recipients under that Nondisclosure Agreement have signed the attached Access Agreement.

Conclusion

The Commission should restrict disclosure of certain proprietary vendor pricing information under the terms of the Nondisclosure and Access Agreements attached hereto, and should close its investigation without requiring any modification to the tariff.

Respectfully submitted,

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Exhibit A

AFFIDAVIT OF
WILLIAM E. TAYLOR, Ph.D.

I, William E. Taylor, being duly sworn, depose and say:

1. I am Senior Vice President of National Economic Research Associates, Inc. (NERA) and head of its Cambridge office, located at One Main Street, Cambridge, Massachusetts 02142. I have been an economist for over twenty years. I received a B.A. degree in economics (Magna Cum Laude) from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. I have taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.) and have published research on economic costing and pricing in broadband networks. I have participated in telecommunications regulatory proceedings before state public service commissions and the Federal Communications Commission concerning competition, incentive regulation, price cap regulation, productivity, access charges, pricing for economic efficiency, and cost allocation methods for joint supply of video, voice and data services on broadband networks. A copy of my vita is provided as Attachment 1 to this Affidavit.

2. I prepared this Affidavit at the request of Bell Atlantic to appraise, from the perspective of an economist, the methods used to support its tariff to provide Video Dialtone (VDT) Service in light of the Commission's investigation.[1] In particular, I address four issues raised by the Commission: (i) the allocation of costs by minutes of use (MOUs) to determine whether a service makes *de minimis*

[1] Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10, Rates, Terms and Regulations for Video Dialtone Service in Dover Township, New Jersey, Order Designating Issues for Investigation, (the *Investigation Order*), CC Docket No. 95-145 (released Sept. 8, 1995).

use of a facility; (ii) the equal allocation of non-incremental shared primary plant costs to VDT and telephony (the 50/50 allocation scheme); (iii) the reasonableness of Bell Atlantic's overhead loadings for VDT service; and (iv) the magnitude of Bell Atlantic's volume and term discounts.

The Economic Principles of Cost Allocation and Pricing

3. The economic principles underlying Bell Atlantic's cost allocation and pricing methodology for VDT service were presented in my prior affidavit filed in this case.[2] While the issues in the Commission's investigation delve further into details of the cost allocation and pricing of VDT services, they do not require a new set of economic concepts to justify the validity of the prices set forth in Bell Atlantic's tariff. Before the individual issues are analyzed, it is worthwhile to recall the fundamental economic concepts.

4. In competitive markets, prices are not set explicitly by firms in response to careful cost studies. Rather, costs affect prices implicitly; firms try to sell as much as they can at the market price, and if their costs are low enough to permit a profit at that price, such firms expand and persist. Price cap regulation for new services attempts to achieve a similar outcome by measuring forward-looking total and incremental costs and using those measures to determine price floors (to prevent prices which are too low) and price ceilings (to prevent prices which are too high). As noted before, two economic principles should be used to compare costs and prices in these circumstances: i) cost causation should determine an efficient price floor, and (ii) the ability to sell the product in the market should determine an efficient mark up of price above that floor:

> ...all economists recognize that after incremental costs are directly assigned to services on the basis of cost-causation, the assignment of the remaining fixed common costs to services, <u>on a cost basis</u>, is arbitrary. And such costs have no relevance in determining whether or not VDT service is receiving a subsidy: as long as the incremental revenues from the provision of VDT service exceed the incremental--directly, cost-causally assigned--costs of VDT service, all customers are better off if the service is provided. While allocation of fixed costs is an inherently arbitrary process, there are cost allocators that, though arbitrary, are reasonable. After all, unregulated multiproduct firms in competitive markets take market prices as given, and yet, in

[2] Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, and Regulations, Transmittal Nos. 741, Bell Atlantic Reply Comments, Affidavit of William E. Taylor (March 6, 1995).

> equilibrium, recover their total costs from prices which equal or exceed their incremental costs in each market. Those prices can be thought of as "reasonable" allocators of cost and are reasonable because the "allocators" are determined by competitive processes in different markets.[3]

The effect of using different allocators can be enormous, and any cost allocation scheme must be calibrated against the effect in the retail markets for the services whose prices would be set using allocated costs. Market forces will determine the level at which service prices are set above direct incremental costs:

> A reasonable (but arbitrary) allocator of costs for a regulated firm likewise would depend on market conditions and the demand for the service in question. To take a simple case, any allocator that ignores the market and causes prices for a service to be set above the level that would maximize the contribution (price less incremental cost) that the firm would receive from the service is unreasonable. A smaller allocation of overhead costs and consequently a lower price would make all parties better off. Customers of the service in question would prefer lower prices and would buy more at the lower price. The net revenue of the regulated firm would be higher, so that either (i) customers of other services would receive lower prices or (ii) other prices would remain unchanged and the firm's earnings would increase. In general, all parties to the transaction would be made better off if the firm were permitted to lower prices to the contribution-maximizing level.[4]

5. The Commission's regulations for new services subject to price cap regulation base the price floor on the firm's direct costs plus the allocation of a reasonable amount of common costs. The price ceiling is determined by adding a reasonable level of overhead to the floor. Within these bounds, an efficient price is determined by the competitive nature of the market. As observed before,

> ...Bell Atlantic's decision to propose rates above the price floor and at or below the price ceiling is consistent with the principles of efficient pricing. A reasonable allocation of common costs cannot hold the price of a service so high that customers do not purchase the service at all or sales of one vendor or one technology are

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[3] <u>Ibid</u>, at 4.

[4] <u>Ibid</u>, at 4-5.

> preferentially treated in comparison with its competitors. The efficient choice of goods and services, vendors and technologies must be made at the margin--so that for services perceived to be of equal quality the service having the lower marginal cost has a competitive advantage. If this advantage is distorted through a required unreasonable allocation of common costs, the potential efficiency gains from competition in video distribution will be lost.[5]

This concept applies to all VDT prices, including volume and term discounts, that recover their directly assigned costs and any portion of overhead loadings. Furthermore,

> As a new entrant in a competitive market, Bell Atlantic must set its discount prices above the price floor, but the extent to which it contributes to the overhead costs depends on the VDT-related market, not the telephony market. Thus, the level of contribution included in the price of competitive services should not be determined by the level of contribution previously recovered in Bell Atlantic's rates. Ultimately, if Bell Atlantic's revenue from VDT services does not materialize to cover the costs, it is Bell Atlantic that pays for the error, not Bell Atlantic's other interstate or intrastate customers.[6]

As long as Bell Atlantic's prices recover direct incremental costs and any portion of common costs, all of its customers are better off. The level of contribution above the price floor should be dependent on the level of competition in the market.

6. Not only did Bell Atlantic conform to the Commission's rules,[7] but it properly set VDT prices on the basis of two economic principles described above -- cost-causation and marketplace realities. As I observed before,

> ...Bell Atlantic assigned all those costs that are caused by the provision of VDT services or that vary with the volume of VDT

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[5] Ibid, at 9-10.

[6] Ibid, at 14. Interstate telephone customers are protected because interstate price cap regulation separates changes in costs from changes in prices. Intrastate customers are similarly protected by price cap regulation in New Jersey.

[7] Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58 and Amendments of Parts 32, 36, 61, 64, and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, (the *Reconsideration Order*) CC Docket No. 87-266, 10 FCC Rcd 244 (1994).

> services supplied, as well as a reasonable portion of shared and other common costs, directly to VDT services.[8]

A Minute of Use Threshold for a *De Minimis* Showing is Unreasonable

7. The *Investigation Order* asks what the effect would be of considering

> equipment which has 10 percent or less of its total usage, as measured by minutes of use, from a secondary service to be wholly dedicated to the primary service (at ¶ 14).

While there may well be administrative or other advantages to ignoring *de minimis* uses of facilities for particular services, relying on minutes of use as the method by which a use is determined to be *de minimis* is inappropriate. An MOU allocator is both arbitrary and unreasonable; indeed, it is just as unreasonable as a determinant of *de minimis* use as it would be as a general allocator of common costs. Consider, for example, the capital and maintenance costs of a truck used to haul fruit to market. Filled with apples and oranges, it may be sensible to assign all of the truck's costs to apple production if oranges constitute less than 10 percent of the total number of pieces of fruit. When the truck is filled with apples and watermelons, this definition becomes less appealing. When it contains apples and pianos, it becomes nonsense.

8. Video channels, like special access lines, provide transport over dedicated facilities and allow the customers of the channels to determine monthly usage of its facilities. In fact, for the broadcast and narrowcast services currently being offered in Dover under this tariff, channels are used 24 hours a day, 7 days a week, to transmit a one-way stream of broadcast signals. Since transport -- not usage -- is purchased, the prices paid by customers appropriately have nothing to do with the number of minutes a facility is used by the ultimate subscribers.

9. In light of the inability of the equipment to measure adequately the relative MOUs and the lack of any other existing commercial VDT service from which to derive relevant data, there is no reasonable way for Bell Atlantic to predict how many MOUs the video programmers intend and hope

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[8] Affidavit of William E. Taylor (March 6, 1995), at 9.

to move through the video channels. Although the Commission implies that local exchange carriers (LECs) can determine whether a special access line is primarily used for interstate or intrastate traffic, LECs are able to make that assessment only based on data provided by the long-distance carrier using the dedicated facility. Bell Atlantic and other LECs do not have independent knowledge concerning actual MOUs of equipment associated with dedicated facilities. Moreover, reliable data on the actual number of video programming minutes that will be transmitted over video facilities is not available. Bell Atlantic's VDT offering in Dover is the first of its kind, so any usage data would be an unreliable forecast based on no actual experience. Even in the event that usage data were available, it could not reflect the rapid and dramatic changes that are likely to occur in video programming, as new competitors enter the market or technological changes transform video programming in general.

10. Proxies of relative use between video and telephony will also yield "absurd"[9] results. For example,

> the average residential telephone is used only about 23 minutes each day while the average television set is on approximately seven hours daily. Thus if relative use is based on time and through-put, the 15.00 per month basic video charge would translate into flat rate telephone service of one-tenth of a cent per month.[10]

Under such a scenario, all voice transport could be considered *de minimis*, which would thereby place the full cost of the integrated network on VDT. Such an allocation would distort the total cost of supplying VDT services, making all customers worse off. In addition, results based on total bits of information transmitted, holding time and number of distinct calls, for example, could also produce unreasonable prices of either telephony or VDT services.

The 50/50 Allocation Scheme for Shared Costs Unnecessarily Impairs Competition

11. From an economic point of view, shared or common costs cannot be directly assigned to a service because direct assignment implies the attribution of costs by cost causation. The Commission's proposed 50/50 allocation is tantamount to an attempt to assign a direct amount (50%)

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[9] R. Pepper, "Through the Looking Glass: Integrated Broadband Networks, Regulatory Policies and Institutional Change," Office of Plans and Policy Working Paper No. 24, 4 FCC Rcd 1306, 1313 (1988).

[10] Id. (citations omitted).

of shared costs to both VDT and telephony. Any attempt to use a 50/50 allocation of common costs between telephony and video services to set prices has no reasoned basis. In addition, a 50/50 allocation may harm the competitive prospects of Bell Atlantic's VDT service by pricing it above the rate the marketplace warrants.

12. Furthermore, the ostensible fairness of an equal allocation of shared costs between video and telephony services is misleading. In reality, fairness is not a relevant concept in distributing common costs, since these costs do not belong to any service in particular. An assignment of 33 percent of shared costs to each of voice, data, and video services seems equally "fair," as does a 50/50 assignment of shared costs between switched and dedicated services or between broadband and narrowband services. The "fairness" of using value, volume or weight to allocate track maintenance costs to railroad shippers, however, depends entirely on whether you ship diamonds, feathers or coal. As economists constantly preach, there are no simple tests for fairness in the allocation of common costs.

Overhead Loadings Should Reflect the Marketplace

13. The loadings chosen by Bell Atlantic are reasonable because they do not require VDT service to recover more of the overhead costs than VDT market conditions permit.[11] Moreover, the make-up of the direct costs required by the Commission (before overhead loadings) already exceeds the incremental cost of the service. In particular, the Commission requires VDT's direct costs to "include any incremental costs that are associated with shared plant used to provide video dialtone and other services,"[12] so that the price floor for VDT includes both VDT's incremental costs and an allocation of shared costs. Because Bell Atlantic's VDT prices--both discounted and nondiscounted--are set above incremental plus some portion of shared costs, provision of VDT service will pay its own way and, in addition, contribute to the recovery of the common costs of the firm. Since Bell Atlantic has satisfied the requirement to price above the floor of the service, which is already higher than its incremental costs, any margin above that amount (up to the price ceiling) is beneficial for both customers of the competitive VDT service and customers of every other service. This is because

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[11] *Reconsideration Order*, at ¶¶ 217-220.

[12] Ibid, at ¶ 217.

VDT service makes a contribution to overhead costs and does not unfairly preclude equally efficient firms from the marketplace.

14. Conversely, if Bell Atlantic were required to price its VDT services above competitive levels by increasing the amount of overhead recovery added to direct costs (which already include shared costs), all customers would be worse off as the firm's contribution to its overhead loadings is decreased. That concern is especially relevant here, where VDT service will compete with an established incumbent. This puts added pressure on the price levels of Bell Atlantic's programmer-customers and therefore on Bell Atlantic itself.

15. Moreover, Bell Atlantic has every incentive to recover its overhead costs in an efficient manner. Bell Atlantic's interstate services are currently regulated by "pure" price cap regulation in which cost changes can have no impact on the allowable price levels. There is no sense in which Bell Atlantic can raise telephony rates -- or lower them less than otherwise -- to offset lower profits (or even losses) from VDT.

Bell Atlantic's Market-based Volume and Term Discounts are Reasonable

16. Bell Atlantic's volume and term discounts are not "unduly" discriminatory.[13] Discounting services or merchandise is a widespread and practical business tool in competitive markets. As long as the service, in this case VDT, recovers its incremental costs, it is not receiving a subsidy. The Commission's definition of direct costs for VDT service, however, already includes some portion of shared costs in the price floor for the VDT rates, including the discounted rates. The amount of the margin to recover for a particular service, however, should be dependent on the competitive nature of the marketplace, rather than a preset amount typically reserved for traditional telephony services. Bell Atlantic's discounts are optional and open to any programmer willing to meet the minimum requirements, so they do not discriminate against any particular programmer. If customers opt for the

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[13] *Investigation Order*, at ¶ 46.

discounts, they will compensate Bell Atlantic for its incremental and shared costs and a portion of the common costs, thus making all customers better off.[14]

17. Cost data alone cannot determine whether particular volume or term discounts are reasonable or fair. In competitive markets, such discounts depend on a variety of market-driven factors such as reduced churn and reduced uncertainty. Volume and term discounts are an effective pricing tool that can increase total purchases. Thus, the reasonableness of particular discounts, regardless of whether or not the market is regulated, cannot be determined by cost studies alone no matter how carefully done.

18. As with other services, the Commission's requirement that services be made available for resale on an unrestricted basis provides a sufficient safeguard against undue price discrimination through volume and term discounts. As long as the volume and term discounts are available for resale, arbitrage will ensure that the differential between Bell Atlantic's high-volume, long-term prices and its low-volume, short-term price is efficient. If the volume and term discounts are inefficiently large, a reseller could aggregate traffic -- over both customers and time -- to qualify for volume and term discounts, and if it could perform this function at a lower cost than Bell Atlantic, it would exert intrabrand pricing pressure on Bell Atlantic's low volume services until the price differential fell to a competitive level.

Conclusion

19. The specific issues the Commission has identified for investigation raise no new issues of economic principle. In attempting to assess the reasonableness of particular allocations of shared and common costs, it is important to remember that only two economic principles apply: (i) cost causation should determine an efficient price floor, and (ii) the ability to sell the product in the market should determine an efficient mark up of price above that floor. Deviations from these principles -- however well-intended -- can have catastrophic effects on the ability of competitive market forces to determine which firms and which technologies will best serve video and telephony customers in the future.

[14] While Bell Atlantic's tariff filing shows that VDT term and volume discounts are above incremental and shared costs, a separate showing is not warranted under circumstances where a LEC is offering discounts for existing services. Only in a complaint process should a LEC be compelled to provide data in addition to the tariff filing which introduced the service.